SUPREME COURT, U. S.

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IN THE

# Supreme Court of the United States

OCTOBER TERM, 1970

No. 914

GEORGE R. TOLLEFSEN and MARGARET A. TOLLEFSEN,

*Petitioners,*

v.

COMMISSIONER OF INTERNAL REVENUE,

*Respondent.*

## PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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## PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

Petitioners pray that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Second Circuit, entered in the above-entitled case on June 19, 1970.

### Opinions Below

The opinion of the Court of Appeals, as yet unreported, is printed in the Appendix, *infra*, pp. 1a-8a. The opinion of the Tax Court of the United States is reported at 52 T.C. 671, and is printed in the Appendix, *infra*, pp. 9a-26a.

### Jurisdiction

The judgment of the Court of Appeals was entered on June 19, 1970. By order of this Court, dated September 16, 1970, Mr. Justice John M. Harlan, extended the time

for filing this petition for writ of certiorari to and including October 31, 1970. The jurisdiction of this Court is invoked under 28 U.S.C. Sec. 1254(1).

## Questions Presented

1. Did the Court below err when it determined that the Tax Court's decision finding that advances to petitioner by subsidiary-corporation in amount of $24,665.40 during 1961 were not intended as a loan to him, as contended by petitioners, but were constructive dividends received by them from parent-corporation, within the purview of Secs. 301 and 316, I.R.C., was not clearly erroneous and should be affirmed?

2. Did the Court below err in its judgment that such advances to petitioner by subsidiary, were dividends from parent, when the two corporations were *bona fide*, active and successful corporations and retained their separate taxable entities, and there was no proof in the record that source of the funds came from parent and that subsidiary was used as a conduit or subservient instrumentality or a device to escape taxation?

3. Did the Court below err in its judgment that such advances were constructive dividends from parent, when neither petitioner was ever a shareholder of subsidiary and there was no provision in the Internal Revenue Code or Regulations which authorized the rule of attribution and construction adopted?

4. Did the Court below err in rendering judgment that such advances were dividends from parent, when the only

issue raised by the statutory notice of deficiency and the pleadings, and heard by the Tax Court, was whether such advances were dividends from subsidiary?

5. Was the petitioners' right to due process of law, as guaranteed by Fifth Amendment, violated when Court below entered judgment that petitioners received the taxable dividend from parent, and the notice of deficiency, pleadings and evidence heard by Tax Court were confined to the issue whether subsidiary paid such dividend, and Commissioner never charged or alleged that such dividend was paid by parent, and the Tax Court never tried such issue?

## Statutes Involved

The pertinent provisions of Sections 243(a)(1), 301(a) and (c), 316(a), 6212(a) and (c), and 6214(a), of the Internal Revenue Code, 1954 (26 U.S.C.), are printed in the Appendix, *infra*, pp. 27a-29a.

## Statement of the Case

### (1)

The following facts were established in the record by stipulations of the parties and uncontradicted testimony of the petitioner, George R. Tollefsen:

In the years involved herein, and for a number of years prior thereto, the petitioners owned all of the stock of Tollefsen Bros., Inc. (hereinafter called "parent"), and the parent owned all of the stock of Tollefsen Manufacturing Corp. (hereinafter called "subsidiary").

For many years the petitioner was an appointed Commissioner of the State Insurance Fund of New York and an Executive-Trustee of a Savings Bank. He was either a Chairman or a member of several committees in both organizations concerned with investments, budgets and mortgages (R. 21a-23a).[1]

Since 1933, the petitioner has been engaged in the organization and operation, and as sole or principal stockholder, of over 25 corporations. He served as an officer and director of such corporations. On an average, 8 or 10 of these corporations have been in existence each year (R. 23a).

During these years, he personally made loans to almost all of the 25 corporations, and on occasion he or his wife personally borrowed money from some of them (R. 23a-25a). Though these corporations had an established line of credit with their bank, he preferred to lend them money personally whenever they required a loan (R. 46a). Of these corporations, there were three, including parent and subsidiary, to which they lent money and from which they had borrowed (R. 25a). On all of the loans to and from these corporations, it was their practice never to charge interest to the corporations, and no interest would be charged to them by the corporations (R. 46a).

As of December 31, 1961, they lent about $170,000 to six of these corporations, and borrowed about $70,000 from two of them (R. 27a, 50a-51a).

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[1] All "R." references are to the numbered pages of the separately bound agreed Appendix filed in the Court of Appeals, and certified by the Clerk of said Court and filed with the Clerk of this Court.

As of December 31, 1961, and as of date of trial, they personally owned marketable securities, deposits in savings banks and other liquid assets, in excess of $225,000; two homes worth more than $105,000 (without any mortgage on them); the stocks in the corporations they had organized and operated, which had a net book value in excess of $200,000 and a fair market value in excess of such book value; and $170,000 in loans receivable due from six of these corporations. Their personal debts were very few and very nominal in amount (R. 27a, 29a-32a, 50a-51a).

Parent was incorporated in 1933. In addition to owning all of stock of subsidiary and another corporation, it was actively engaged in business, owning real estate, land and machinery, leasing real estate, and purchasing and selling real estate, land and other properties (R. 26a-28a). As of December 31, 1961, the book value of its capital stock was $127,000, and its fair market value was over $315,000 (R. 28a-29a).

Subsidiary was incorporated on December 19, 1955. It was actively engaged in business manufacturing mineral shot and grit, used as abrasive materials in cleaning of ships (R. 58a, 67a).

During 1955 and 1956, petitioner personally loaned subsidiary a total of $1,790.54, which was entered on its books as a loan payable to him; and such loan was repaid to him in 1957 (R. 32a-33a, 47a). In 1959, he also loaned subsidiary a total of $7,149.18, which was similarly entered on its books as a loan payable to him (R. 47a, 108a).

On March 8, 1960, subsidiary sold its fixed assets; and it and petitioner covenanted with vendee not to manufacture

or sell abrasive materials for five years within continental United States (R. 33a-35a, 67a).

Thereafter, petitioner was in a dilemma whether to liquidate subsidiary into parent, under a tax-free liquidation, or to keep its separate entity. In his business judgment, he decided not to liquidate subsidiary at that time because of its good will and important business contacts in the abrasive field (R. 33a-34a).

He then decided that for the best interests of subsidiary, he would borrow money from it for purpose of investigating and developing new methods of producing abrasive materials, and that he would invest personally in related ventures in maritime industry until end of restrictive period. Then he would decide again whether to liquidate subsidiary into parent, or to operate it separately with the new techniques he had uncovered (R. 33a-35a, 46a).

During 1960, he borrowed from subsidiary a total of $34,960.15, and after deducting the $7,149.18 due to him for his advances, he owed the net balance of $27,810.97 for 1960. During 1961, he borrowed a total of $27,000, and after deducting $2,334.60 due to him for his advances, he owed the net balance of $24,665.40 for 1961 (R. 108a).

These advances to petitioner were entered on all of subsidiary's books, records and tax returns, as a loan receivable, owed to it by petitioner. He gave his promissory notes to subsidiary, each time he borrowed from it. He and subsidiary treated and considered these advances at all times as a loan made to him (R. 36a-38a, 108a, 109a-114a).

He testified that when he borrowed such funds, he intended that repayment would be made in full, and that, at

all times thereafter, it was his intention to repay such loan in full (R. 39a, 44a-45a).

During 1960 and 1961, and in 1964, with the $52,000 borrowed from subsidiary and other personal funds, he expended $5,000 on trips to Norway to investigate new methods of producing abrasive materials, and loaned and invested over $115,000 in several corporations related to the maritime industry (R. 35a-36a, 39a-40a).

Between January 31, 1964 and May 11, 1964, he assigned to parent certain claims and a mortgage due to him, in total amount of $88,587.40, and an additional claim due to him for $4,500 on November 30, 1964 (R. 38a, 56a, 101a).

On January 31, 1964 (and prior to a week before June 4, 1964), he realized the fact and was considering whether to offset the debt he owed subsidiary by the larger debt owed to him by parent, or to liquidate subsidiary into parent at that time, which would result in paying his debt in full to subsidiary, as parent owed him more than he owed subsidiary (R. 38a, 53a-54a).

On June 4, 1964, the Revenue Agent began the tax examination of subsidiary which resulted in the notice of deficiency in this case. Subsidiary received letter from said Agent notifying it of his impending examination of its books and records not more than a week or so before June 4, 1964 (R. 53a-54a).

As of date of trial, the claims and mortgage assigned by petitioner to parent, in total amount of $93,087.40, had been paid in full to parent by the respective debtors, except for balance of $7,500 due on the mortgage, and that mortgage was secured by real estate worth about $150,000 (R. 38a, 56a).

Between November 30, 1964 and March 11, 1968, petitioner made advances to subsidiary, and, in its behalf, made a special investment of 50% in a new abrasive processing company and a loan to such company, in total amount of $11,916.80. These amounts were credited by subsidiary to his loan receivable account on its books. These credits paid in full the first two notes and part of the third note issued by petitioner to subsidiary, and were so marked on back of notes (R. 37a, 100a, 110a).

After termination of period under restrictive covenant, petitioner intended that balance of his debt to subsidiary would be paid in full either by offset against larger debt still owed to him by parent, or by liquidating subsidiary into parent, or by his direct payment to it and operating it independently. His uncertainty as to which course would be best to follow was due to the pendency of this tax case (R. 37a-38a, 60a).

For the years 1960 and 1961, petitioners filed income tax returns reporting total adjusted gross income of $30,646.22 and $44,139.66, respectively, and paid income taxes of $3,820.87 and $9,177.39, respectively (R. 70a-77a, 122a-133a).

The advances made to petitioner during 1961 by subsidiary were identical in every respect with those made to him during 1960; similar promissory notes were given during both years; and the books, records and tax returns of subsidiary reflected the same treatment for the advances made during both years, as loans made to him by subsidiary (R. 36a-37a, 40a, 108a, 109a-114a).

Petitioners and District Director signed official Form 872 in March, 1964, which extended period of limitation for

assessment of petitioners' income tax return for 1960, until June 30, 1965 (R. 121a).

(2)

Despite the above evidence, which was not refuted by any testimony or other proofs submitted by the Commissioner, the Tax Court determined that the withdrawals from the subsidiary were not intended as a loan to the petitioner because "at the time of the withdrawals here in issue Tollefsen did not intend to repay such amounts to (subsidiary)"; and then concluded that such withdrawals "were in effect dividends from (parent), petitioners' wholly owned corporation." It made this conclusion even though it found that the two were "separate" corporations, and that the parent "owned 100 percent of the stock of (subsidiary)" and the petitioners were never "record owners of stock in (subsidiary)."

It declared that the ground for such holding was that the petitioner "controlled" subsidiary "through the ownership of all the stock in its parent company" and, therefore, such withdrawals "came to him *through* (parent)" (emphasis by Court) and were "in substance" the distributions of two dividends, first the distribution of a constructive dividend to parent by subsidiary, "with a resulting constructive dividend to petitioners" by parent.

The Court cited no provision in the Code nor any case as authority for such holding. It merely referred to several Tax Court cases for purposes of "comparison."

These cases, as noted by the Court of Appeals, represented two theories. Under the first, the Tax Court "looked through the form of the corporate organization and

recognized the individual taxpayer as a 'shareholder' of the distributing corporation within the purview of section 301(a), *Ben R. Meyer*, 45 B.T.A. 228, 237-38 (1941)." And, under the second, the Tax Court "analyzed the whole transaction as in reality consisting of an indirect distribution from the parent which distribution was caused to be paid from the controlled subsidiary as a conduit, *Jacob M. Kaplan*, 43 T.C. 580, 592 (1965)."

These contrary case references, together with the facts: (a) the notice of deficiency and the pleadings raised only the one issue whether the petitioner received a taxable dividend from subsidiary (as described below, in detail); (b) the Tax Court tried only that one issue; and (c) the contrary findings of the Court that the two corporations were "separate" for the purpose of an effective repayment of the loan, but for the purpose of determining a taxable distribution it found that the withdrawals from subsidiary were received by the petitioner "through" parent, made it very confusing and unclear as to the true basis for the Tax Court's holding.

(3)

The Court of Appeals declared that the Tax Court's determination as to whether the "withdrawal is a loan or dividend is a question of fact which a circuit court of appeals cannot alter unless the determination is not supported by substantial evidence"; and that, "In the case at bar we cannot say that the Tax Court lacked a substantial basis in drawing the inference that there was no intent to repay."

It then affirmed the "Tax Court's holding that the withdrawals were dividends from (parent)."

Similarly, it cited no provision in the Code as authority for such holding. And, as to case authority, it noted that there was no reported appellate case involving the additional factor "of a parent corporation as a vehicle through which the taxpayer controls the corporation from which the withdrawal was made." Then it referred to the two Tax Court cases of *Meyer* and *Kaplan*, described above, which were "compared" by the Tax Court in the instant case, and declared, "We regard the situation at bar to be closer to *Kaplan* than to *Meyer*. Indeed, the Commissioner eschews reliance upon *Meyer* in his brief. Appellee's brief at 21."

The Court of Appeals made its determination despite the substantial evidence and uncontradicted testimony of the petitioner that such withdrawals from subsidiary were intended as a loan to him and were in effect repaid in full before the tax audit began; the several material errors committed by the Tax Court in the rendition of its judgment against the petitioners, as described below; the notice of deficiency, the pleadings and the evidence heard by the Tax Court were limited solely to the issue whether the petitioner received a dividend from subsidiary; the petitioner's right to due process of law was violated in rendering a judgment against him that he received a dividend from parent, which was not supported by the notice of deficiency and the pleadings and was not litigated by the parties; the lack of proof in the record that the funds withdrawn from subsidiary were derived from parent, and that such withdrawals were intended as a "device" to "divert" funds and to "avoid income taxation"; the Tax Court never found that subsidiary was employed as a "conduit"; and the fact that there was no provision in the Code or Regulations which would support such determination.

(4)

In his report against the petitioner, the Revenue Agent specifically determined that he was charged "with a dividend from (subsidiary), 11/30/61," because of his withdrawals from such corporation during 1961 (R. 10a). In his statutory notice of deficiency, the Commissioner determined that petitioner's withdrawals from subsidiary during 1961 constituted a dividend (R. 10a). (Note: No reference was made in either the report or notice that such withdrawals from subsidiary was a dividend or "constructive dividend" from parent.)

In their petition to the Tax Court, the petitioners alleged that they received no taxable dividend from subsidiary during 1961; they never owned any stock in such corporation; and that the advances to petitioner exceeded the amount of such corporation's earned surplus (R. 4a-7a).

In his answer, the Commissioner merely denied these allegations (R. 12a-13a). (Note: No allegation was made in the answer that such withdrawals from subsidiary was a dividend or "constructive dividend" from parent.)

At the trial before the Tax Court, in refutation of the charge that he received a dividend from subsidiary, the petitioner testified and offered proofs that he did not receive a dividend from subsidiary; that neither he nor his wife ever owned any stock in such corporation; that parent owned all of the stock of subsidiary; and that parent was an active and substantive corporation for many years. The Commissioner offered no evidence to contradict such facts; and, in particular, offered no evidence to establish that the dividend was paid by parent. (Note: The issue as to whether the petitioner received a dividend from parent was

never raised at the trial, nor even intimated or discussed by either party.)

In his opening statement to the Tax Court, the Commissioner's attorney stated that the petitioners received the dividend from subsidiary because they owned all of the stock of parent, and parent owned all of the stock of subsidiary; and that "the respondent cites the case of *Ben R. Meyer*, 45 B.T.A. 228, 1941, which, with regard to this particular question, is squarely on point" (R. 20a).

In his brief filed with the Tax Court, the Commissioner stated his point that, "For the purpose of determining the existence of a dividend, petitioner should be treated as a shareholder of (subsidiary)." He argued, "It cannot be contended that because the petitioners were not the record owners of (subsidiary's) stock, that they could not have received a dividend from that company." And, he concluded that, "the petitioners, by virtue of their ownership of (parent), should be deemed, for the purposes of determining whether a dividend has been paid, to be the owners of (subsidiary's) stock. Since petitioners in substance were the owners of and in control of (subsidiary), a holding to the contrary would allow form to prevail over substance" (pages 15-17).

Then, on pages 7-8 of said brief, the Commissioner requested the Tax Court to find as ultimate facts that, "For the purpose of determining the existence of a dividend, petitioner was a shareholder of (subsidiary) during 1961," and that the withdrawals from such subsidiary "constitute unreported distributions of property made by a corporation to a shareholder with respect to its stock out of earnings and profits."

## Reasons for Granting the Writ

### 1.

**The decision below conflicts with numerous decisions of this Court declaring active business corporations to be separate taxable entities, and that ownership and control of such corporations do not determine taxability.**

The decisions of the Courts below, which rest on the theory that merely because petitioners owned all of the stock of parent, and parent owned all of the stock of subsidiary, their respective taxable entities may be ignored, and the receipt of funds by petitioner from such subsidiary may be deemed to have come to him as a "constructive dividend" from parent, even though there was no proof in the record that the source of these funds was derived directly or indirectly from such parent, and that such withdrawals were intended as a "device" to divert funds from subsidiary as part of a "fictional corporate camouflage," are in direct conflict with a number of decisions of this Court.

This Court has determined that when a corporation's "purpose is the equivalent of business activity or is followed by the carrying on of business by the corporation, the corporation remains a separate taxable entity." Its separate entity is retained whether its stock is owned entirely (or partly) by another corporation or by an individual, and regardless of the quantum of such business activity. *Moline Properties, Inc.* v. *Commissioner,* 319 U.S. 436, 438-439 (1943); *National Carbide Corp.* v. *Commissioner,* 336 U.S. 422 (1949).

In the instant case, the evidence established that the two corporations were *bona fide*, active and successful corporations, and retained their separate taxable entities. The Tax Court determined that they were "separate" corporations. Also, the Commissioner acknowledged on pages 12, 19 and 21 of his brief filed in the Court below that the two corporations were "*bona fide* separate corporations" and had "separate entities."

In addition, this Court has determined that "complete ownership of the corporation, and the control primarily dependent upon such ownership * * * are no longer of significance in determining taxability." *National Carbide Corp.* v. *Commissioner, supra,* at page 429; *Burnet* v. *Commonwealth Improvement Co.,* 287 U.S. 415 (1932).

Thus, the mere fact that petitioners owned all of the stock of parent, should not subject them to a tax on funds received by them from its wholly-owned subsidiary, as a "constructive dividend" paid by parent, when the two corporations were separate and distinct taxable entities and there was no proof of "diversion" or "device" employed. The relationship between a corporation "and its shareholders is an abiding one. They obtain the dividend payments because of their status as shareholders." *United States* v. *Joliet & Chicago R. Co.,* 315 U.S. 44, 48 (1942).

This Court should resolve such conflict. To permit the decision of the Court below to stand would create confusion and uncertainty in the relationship between a corporation and its shareholders, and in the significance and meaning of "separate taxable entity" for many thousands of active corporations throughout the country. This Court for many

years has established clear and practical guides for such concepts; these should not be thwarted or ignored.

## 2.

**The decisions of the Courts below are in conflict with each other; the case of *Jacob M. Kaplan*, 43 T.C. 580, cited by the Court of Appeals, as representing a similar basis for its holding, is clearly not in point.**

The Tax Court determined that the withdrawals by petitioner from subsidiary were "in substance" two constructive dividend distributions, subsidiary to parent, and then parent to petitioners. While the Court of Appeals determined that only one dividend distribution was made, and that it was similar to the situation presented in the prior Tax Court case, *Jacob M. Kaplan*, 43 T.C. 580 (1965), "an indirect distribution from the parent which distribution was caused to be paid from the controlled subsidiary as a conduit."

(Note: If the theory of the Tax Court had been followed, then the first constructive dividend distribution by subsidiary to parent would be subject to the special deduction of 85% of such amount, or $20,965.59 to be deducted from the distribution in question, $24,665.40, leaving a net taxable dividend of $3,699.81. Such deduction was specifically allowed by Sec. 243(a)(1), I.R.C., when a corporation received a dividend from another corporation. Then, at most, only $3,699.81 could be distributed by parent to petitioners in the second constructive dividend distribution, and not the full amount of $24,665.40, as determined by the Tax Court.)

The Court of Appeals changed the Tax Court's theory of two distributions, and followed the holding of the *Kaplan* case, even though neither the Tax Court found nor the facts established that the subsidiary was used as a "conduit" to divert such distribution. (The Court noted in its opinion that even the Commissioner in its brief before such Court had changed its theory of the case from the principle set forth in the *Meyer* case, to that of the *Kaplan* case.)

In the *Kaplan* case, the Court found a plan among the petitioner therein, parent and subsidiary which "was a fictitious maneuver that was nothing more than a sham"; that substantial "assets were shifted" (almost $3,000,000, net) from the parent to the "newly created" subsidiary; that the subsidiary "was in no financial position to participate, through its own volition, in the plan which petitioner formulated"; and that "the source of all the withdrawals which petitioner received in 1952 was the funds of (parent) which (subsidiary) then possessed through forbearance of its said parent corporation." The Tax Court concluded that such withdrawals of $1,000,000 from the subsidiary were dividends paid by parent, and were "taxable as dividends to the extent of (parent's) earnings and profits" as the petitioner had caused such distribution "to be paid to him through the medium of (subsidiary), as a conduit and subservient instrumentality."

Said cited case was clearly not in point, as no facts were established in the record herein (and neither did the Tax Court so find) that the source of the advances to petitioner herein was the funds of the parent, or that the subsidiary was used as a "conduit" or "subservient instrumentality" or a "device to escape taxation."

Settlement of the issue raised herein concerning the employment of a corporation as a "conduit" is in the public interest. The interpretation given by the Court below, without proof that the source of the funds came from the parent and that there existed a plan to "divert" such funds through the subsidiary "as a conduit and subservient instrumentality," sets forth a view which is clearly contrary to the fundamental concepts in taxation of dividends received from a parent or a subsidiary corporation. Widespread litigation will most certainly follow if this issue is not settled by this Court.

**3.**

**The decision below is contrary to the fundamental concepts of the law of taxation under the Internal Revenue Code that income may not be created where none existed, and where no provision in the Code or Regulations authorized the rule of construction adopted.**

Neither decision in the Courts below cited any provision in the Code or Regulations (it is submitted, that no such provision exists) which would support their determinations that the advances made to petitioner by subsidiary in the amount of $24,665.40 was a constructive dividend paid by parent in that amount, within the purview of Secs. 301 and 316, I.R.C., merely because of the shareholdings of the respective corporations as presented herein. (Neither Court found any facts in the record herein to support their determinations that petitioner received a "constructive dividend" from parent, beyond the "cold" facts that petitioners "owned 100 percent of the stock of (parent) and the latter owned 100 percent of the stock of (subsidiary).")

In Sec. 318, I.R.C., the Congress enacted a detailed provision concerning rules of control, attribution and constructive ownership of stock, as they affect other provisions of the Code. In subsection (b), eight other sections of the Code are listed in which such rules of control and constructive ownership of stock, as contained in subsection (a) thereof, "are expressly made applicable." Neither Sec. 301 or 316, providing for "dividends" distributed "by a corporation to its shareholders" is listed therein. If the Congress intended that an individual owning all (or a fixed percentage) of the stock of a parent-corporation shall be constructively the recipient of a dividend from parent, when such "dividend" is distributed by subsidiary, then such provision would have been "expressly made applicable" by the addition of Sec. 301 or 316 to said subsection (b) of Sec. 318.

Accordingly, without grant of authority under the Code, the decision of the Court below was erroneous as a matter of law as it "set up income where none existed" (*Tennessee-Arkansas Gravel Co.* v. *Commissioner*, 112 F.2d 508, CA 6, 1940) and as it was contrary to the principle established by this Court that such factors of ownership of stock and control dependent upon such ownership "are no longer of significance in determining taxability."

The issue whether a taxpayer may be taxed on "income" where it was arbitrarily "created" and "none existed," and without grant of authority under the Code for a special rule of attribution and constructive ownership of stock which may "set up" such income from a "constructive dividend," should be settled by this Court. It is of great importance and significance in the sound administration of the income tax law under the Code.

**4.**

**The judgment of Court below, that petitioners received the dividend in question from parent, was erroneous as a matter of law, as neither the notice of deficiency nor the pleadings made such issue, and the Tax Court never tried such issue; the Tax Court and the Court of Appeals were without jurisdiction to make such redetermination.**

The statutory notice of deficiency, the pleadings and the evidence heard by the Tax Court were confined to the issue whether subsidiary paid a taxable dividend in amount of $24,665.40 to petitioner.

Nowhere in such notice and pleadings was the issue ever made or alleged that petitioner received such taxable dividend from parent, directly, indirectly or constructively. Also, at the trial before the Tax Court, no evidence was presented, and the Commissioner did not even argue or contend, that parent paid such dividend to petitioner, whether directly, indirectly or constructively.

Accordingly, the decision of the Court below affirming the "Tax Court's holding that the withdrawals were dividends from (parent)," was erroneous as a matter of law. It was contrary to the well-established principle adopted by all Courts and all legal authorities that a judgment based on an issue not made by the pleadings and not litigated between the parties, is *"coram non judice* and void."

In tax cases under the Code, such principle must be even more stringently applied. Pursuant to Sec. 6214(a), I.R.C., the jurisdiction of the Tax Court is limited only "to redetermine the correct amount of the deficiency" and to de-

termine whether any "additional amount" should be assessed, if the Commissioner asserted a claim therefor "at or before the hearing" of the case.

Thus, the Tax Court and the Court of Appeals were without authority under the Code to enter a completely new and different judgment that the dividend in question was paid by parent, when the Commissioner determined in his notice of deficiency that such dividend was paid by subsidiary; and, at the same time, such judgment was void under general law, as the issue whether the dividend was paid by parent was never made by the pleadings and never litigated by the parties.

Further, even if the Commissioner had desired to assert the new determination that the dividend was paid during the same taxable year by parent, he was barred from making such additional determination under Sec. 6212(c), I.R.C., after he had mailed his original notice of deficiency and the petitioner had filed a timely petition with the Tax Court.

Actually, the Commissioner never amended his statutory notice of deficiency or his answer filed with the Tax Court. His charge and determination at all times was that the dividend was paid by subsidiary.

In addition, throughout the hearing before the Tax Court, the Commissioner contended that the principle set forth in the *Meyer* case, "is squarely on point"; and, for the purpose of determining whether petitioner received a dividend from subsidiary, he was a "shareholder" of subsidiary.

This Court should settle whether a judgment which conflicts with the specific provisions of the Code concerning the limits of the Tax Court's jurisdiction, and which is

contrary to fundamental principles of legality adopted by all legal authorities and all Courts, should be permitted to stand. The limits of the Tax Court's jurisdiction should be defined by this Court, as a matter of public interest and as a guide for all taxpayers.

## 5.

**The judgment of the Court below violated the petitioners' right to due process of law, as guaranteed by the Fifth Amendment.**

Until "the Commissioner eschew(ed) reliance upon *Meyer* in his brief" filed in the Court of Appeals (as noted by the Court in its opinion) and until said Court rendered its judgment "that the withdrawals were dividends from (parent)," the notice of deficiency, the pleadings and the hearing before the Tax Court were directed and presented by the Commissioner against the petitioners herein on the charge that they received the dividend in question from subsidiary; that they were the "shareholders" of subsidiary, even though he acknowledged and the Tax Court found that parent "owned 100 percent of the stock of (subsidiary)"; and that the *Meyer* case was "squarely on point."

In view of the notice of deficiency and the pleadings herein, the petitioner confined his testimony and proofs at the trial before the Tax Court to prove: he did not receive a taxable dividend from subsidiary; neither he nor his wife was ever a shareholder of subsidiary; parent owned all of the stock of subsidiary; parent was a *bona fide*, active and successful corporation, and not a "shell" or "dummy" or "sham or unreal" corporation; and parent retained its separate taxable entity.

The Commissioner introduced no evidence to refute these facts, but merely contended that the petitioners received the dividend from subsidiary and that they were the "shareholders" of subsidiary, "by virtue of their ownership of (parent)."

Accordingly, the petitioners respectfully submit, that their right to due process of law, as guaranteed by the Fifth Amendment, had been violated when the Court below entered judgment affirming the judgment of the Tax Court, and holding that the petitioners received the taxable dividend from parent.

The petitioners were entitled to proper judicial proceedings as guaranteed by the Constitution and as provided under the Internal Revenue Code. As the issue, whether they received the taxable dividend in question from parent was not before the Tax Court (and was never in fact "tried" by the Court)—neither the notice of deficiency nor the pleadings made or alleged such charge or issue—the petitioners submitted no evidence on such issue, the Commissioner offered no evidence on such issue, and the Tax Court never conducted a "hearing" on such issue. Therefore, the petitioners never had their "day in Court" on such issue.

The violation of petitioners' rights on this point may further be noted when the Court below declared that its holding that the withdrawals were dividends from parent, "makes irrelevant Tollefsen's arguments that (parent) cannot be considered a 'shell' or a 'dummy' corporation and that he cannot be considered a 'shareholder' of (subsidiary)." The Court ignored the principle that the petitioners' proofs and testimony on these facts were definitely relevant, if it and the Tax Court had exercised their jurisdiction as provided under the Code and as guaranteed by the

Constitution, and redetermined only the issue charged by the notice of deficiency and raised by the pleadings.

In addition, when the Court below discussed its proposed findings as to which corporation paid the dividend in question, it declared that the case "must be explicit in articulating the theory under which Tollefsen can be said to have received a 'dividend.'" Yet, it violated its own rule when it entered the judgment holding that parent paid the dividend to petitioner, even though it was aware that the notice of deficiency, the pleadings and the evidence heard by the Tax Court were directed solely to the issue whether subsidiary paid such dividend.

This Court should settle in the public interest whether the fundamental requirement of due process of law, "notice, and an opportunity to be heard and to defend in an orderly proceeding adapted to the nature of the case," may be ignored by the Commissioner in his attempts "to collect the revenue."

## 6.

**The Court below erred, as a matter of law, when it affirmed the judgment of the Tax Court, which was clearly erroneous, void and entered in violation of petitioners' right to due process of law under Fifth Amendment.**

The Tax Court committed the following errors when it entered judgment that the advances to petitioner during 1961 by subsidiary, were constructive dividends paid to petitioners by parent:

1. It stated that no evidence was presented to establish the fair market value of the claims assigned by petitioner to parent. Petitioner's uncontradicted testimony was that these claims and mortgage assigned to parent were paid in full as of date of trial, except for a balance of $7,500 due on the mortgage and that mortgage was secured by real property worth $150,000.

2. It stated that no evidence was presented to establish that these assignments to parent were intended as repayments of withdrawals from subsidiary. Petitioner's uncontradicted testimony was that because parent owed him more than he owed subsidiary he considered his debt paid in full; also, he considered whether to offset such debt by the larger debt due to him by parent, or to liquidate subsidiary into parent, which would also result in paying his debt in full.

3. It stated that the promissory notes given by petitioner to subsidiary for these advances to him, bore no interest and no interest was paid thereon. Petitioner's uncontradicted

testimony was that on all loans made by petitioners to the corporations he had organized and operated, and on the loans made by these corporations to the petitioners, it was their practice never to charge interest to the corporations, and no interest would be charged to them by the corporations.

4. It stated that petitioner made no payments on account of the amounts withdrawn during 1960 and 1961. The petitioner's uncontradicted testimony and the parties' stipulation of facts established that $7,149.18 advanced by petitioner in 1959 was credited by subsidiary against the amount withdrawn in 1960; that $2,334.60 advanced by petitioner in 1961 was credited by subsidiary against amounts withdrawn in 1960 and 1961; and that $11,916.80 advanced by petitioner from November 30, 1964 to March 11, 1968 was credited by subsidiary against amounts withdrawn in 1960 and 1961. In addition, petitioner's uncontradicted testimony was that he considered his debt to subsidiary paid in full because parent owed him more than he owed subsidiary, as described above.

5. It stated that there was no pattern of reciprocal loans to and from his corporations, and no showing of any such pattern of reciprocal loans "of consequence" to subsidiary. The petitioner's uncontradicted testimony and the parties' stipulation of facts established that he made loans to and from parent in amounts larger than the sum borrowed from subsidiary; and that he made loans for $1,790.54 and $7,149.18 to subsidiary prior to 1960 (and these amounts were certainly "of consequence" compared to his debt of $24,665.40 questioned by the Commissioner). In addition,

petitioner's uncontradicted testimony was that petitioners frequently made loans to the corporations he organized and operated, and on occasion they borrowed from such corporations; that as of December 31, 1961, they lent $170,000 to six of these corporations, and borrowed about $70,000 from two of them; that it was their practice never to charge or be charged interest on the many loans made to and from such corporations.

6. When petitioner testified that his advances of $170,000 to six of the corporations, as of December 31, 1961, were loans made by petitioners to these corporations, it stated that that was his "conclusory description of such advances," and that it would not accept such testimony as these advances "may well have been capital contributions." The petitioner testified in great detail that he frequently made loans to almost all of the corporations he organized and operated; that though these corporations had an established line of credit with their bank, he preferred to lend them money personally whenever they required a loan; and that, as of December 31, 1961, the petitioners lent a total of $170,000 to six of these corporations. The Commissioner did not cross-examine or question the petitioner on such testimony at the trial, as to whether such advances of $170,000 might represent something other than "loans"; and neither did the Commissioner introduce any evidence to refute such direct testimony. From the date the tax examination began to the date of trial, a period of four years, the Commissioner had conducted detailed examinations and hearings (and received affidavits and other proofs from petitioners) by his Revenue Agent, his Review Staff, his Conference Division, his Appellate Division, and his Regional Counsel. Certainly, he had full opportunity to challenge

the veracity of such direct testimony. Further, the Court overlooked the fact that it specifically found that, "Tollefsen at times made interest-free personal loans to some of his corporations."

7. It found that parent and subsidiary were "separate" corporations for the purpose of disputing an effective repayment of the loan from subsidiary, because of the larger debt due to petitioner by parent, yet, for the purpose of determining the taxability of such advances to petitioner, it found that these funds were received by petitioner "through" parent. Such inconsistent findings were unreasonable and arbitrary.

8. It stated that its confidence in petitioner's testimony was "greatly shook" because he testified that he borrowed the money from subsidiary for purpose of carrying on its business interest, during the five-year period under the restrictive covenant against himself and subsidiary, and then he employed most of such funds to acquire other business interests in his own name. Such gratuitous statement by the Court was definitely baseless. The Court overlooked the fact that out of the total of $93,837.40, in claims and mortgage assigned by petitioner to parent in 1964, $73,837.40 represented his claim against Port O'Call Corp.; and that he had made investments and loans to such corporation with part of the funds he had borrowed from subsidiary. Thus, as parent owned all of the stock of subsidiary, as such assigned claim was almost three times as large as his loan being questioned, as he always considered his debt to subsidiary offset by such assignments to parent, and as he frequently considered liquidating subsidiary into parent, in a tax-free liquidation, there was certainly

nothing "unusual" about his employment of the borrowed funds as described. Further, the petitioner testified that he was in a dilemma as to the best course to follow, and that he exercised his business judgment to the best of his ability, in making such investments in his own name for the time being and until the restrictive covenant had terminated. When the petitioner exercised his business judgment to the best of his ability, and which he believed was for the best interest of subsidiary, that should not be disturbing to the Court, unless it had been established in the record that he had fabricated his testimony or that he possessed a base motive in the exercise of such judgment. Clearly, neither of these had been proved, nor even intimated, by the Commissioner.

9. The Revenue Agent and the Court acknowledged, and the facts established, that the withdrawals during 1960 and 1961 represented one continuing transaction, and that those made during 1961 were identical in every respect with those made during 1960. The Court erred, as a matter of law, when it upheld the Commissioner's determination that the 1961 withdrawals were "dividends" while those made during 1960 were accepted by him as "loans." When the Revenue Agent examined the records of subsidiary and petitioners in 1964, the Commissioner had until June 30, 1965 under the formal agreement made between him and the petitioners, and until April 15, 1967, under Sec. 6501(e)(1), I.R.C., to make an assessment against petitioners on the withdrawals made during 1960. It would be unreasonable and arbitrary to accept the view that Commissioner "included only the 1961 return because he thought the statute of limitations had run on the 1960 return," as a legal basis for waiving his "inconsistent" and "unequal" deter-

minations in this situation. The Courts have frequently held that there is a duty upon the Commissioner, as well as the taxpayer, to be consistent and equal in his treatment of a transaction which continues from year to year. "In income taxation what is done in one tax year is sometimes projected into another where the same fact must govern. There being continuity, there ought to be consistency in treatment. * * * It is no more right to allow a party to blow hot and cold as suits his interests in tax matters than in other relationships. Whether it be called estoppel, or a duty of consistency, or the fixing of a fact by agreement, the fact fixed for one year ought to remain fixed in all its consequences." (*Alamo Nat. Bank* v. *Commissioner*, 95 F.2d 622, 623, CA 5, 1938.)

10. Without grant of authority under the Code, the Court erred, as a matter of law, when it determined that withdrawals from subsidiary, were "constructive dividends" paid by parent, merely because petitioners owned all of the stock of parent, and parent owned all of the stock of subsidiary. If the Congress had intended such special rule of attribution and constructive ownership to be applied in the case of "withdrawals" from subsidiary, to be attributed as a "dividend" from parent, it would have made such appropriate provision in Sec. 318, I.R.C.

11. The Court erred, as a matter of law, in rendering its judgment that the petitioners were taxable on the dividends paid by parent, as it was without jurisdiction under the Code to make its redetermination that the petitioners were taxable for dividends paid by parent, when the statutory notice of deficiency charged that the dividends were paid to them by subsidiary; it was void, as the notice of de-

ficiency, the pleadings and the evidence heard by the Court were confined to the issue whether subsidiary paid such dividends; and it was entered in violation of the petitioners' right to due process of law under the Fifth Amendment, as they never had "notice, and an opportunity to be heard and to defend in an orderly proceeding" on such issue, and, actually, the Court never tried such issue.

Accordingly, after examining the above errors, weighing the undisputed facts presented in the record by the parties' stipulation of facts and the uncontradicted testimony of petitioner, and noting that there was no proof in the record that the source of the funds advanced to petitioner came from parent or that such advances were intended as a "device" to "divert" the funds and to "avoid income taxation," it is submitted, that the Court below erred, as a matter of law, in affirming the judgment of the Tax Court.

This Court should settle in the public interest the important questions presented in this case. These include the problems of "controlled" corporations in a parent-subsidiary relationship; the application of rules of attribution and constructive ownership of stock in a "dividend" situation, without grant of authority under the Code; the duty imposed upon Commissioner and the taxpayer to be consistent and equal in the treatment for tax purposes of a transaction which continues from year to year; the limits and extent of the jurisdiction granted to the Tax Court under the Code; the significance of a proper statutory notice of deficiency and an orderly hearing by the Tax Court to redetermine the correct amount of the deficiency; the fundamental right granted under the Constitution to be duly cited and to be heard on the issue determined by the Tax Court; and the weight to be given to a judgment

rendered by the Tax Court under the Code, when the record established that numerous errors had been committed as a matter of law and that its rendition was clearly erroneous.

## CONCLUSION

**For the reasons set forth above, it is respectfully submitted that this petition for a writ of certiorari should be granted.**

Respectfully submitted,

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